CITY OF READING, PENNSYLVANIA

FINANCE DEPARTMENT REVIEW

March 2006

March 29, 2006

Mr. Leon Churchill
Managing Director
City of Reading
815 Washington Street
Reading, PA 19601

Dear Leon:

Attached is the report of our review of the City's Finance Department. You know that having a solid infrastructure in place for managing the City's finances is a critical step as you look to achieve financial stability for Reading.

The Department and the City face many challenges. This report provides you with a road map for implementing improvements that can improve operational efficiency and strengthen the financial capacity of your organization.

We hope this document is helpful in continuing to move the organization forward.

Sincerely,

Julia D. Novak
Regional Vice President

TABLE OF CONTENTS

TABLES

EXECUTIVE SUMMARY

The City of Reading's Finance Department has recently experienced numerous organizational changes. These include new department leadership, a new enterprise resource management software system (known as Hansen) and outsourcing the Department's lockbox function.

Any one of these changes would require some period of adjustment, but for the employees in the Finance Department, they come on top of a backlog of work that continues to grow. The tax season is about to begin in earnest. Thousands of tax forms soon will be mailed to or dropped off at City Hall. Those forms will enter a system that just barely finished processing tax returns from the previous tax year (2004).

The City also faces a bleak fiscal outlook during the next few years unless significantly more revenue becomes available and/or expenses decline dramatically. (Under a separate scope of work, Management Partners has prepared a financial forecast model for the City.) On a macro level, state legislators now are talking seriously about reforming the local government tax collection system used to collect and process Act 511 taxes.

Yet all this change and turmoil also make it a good time to create a road map to improve department operations. The new senior management team in place has new ideas and fresh perspectives. A core group of dedicated and knowledgeable supervisors and employees remain in the department, and in other City departments that interface with the Finance Department. These employees are eager to be part of developing and implementing improvements in Finance Department operations.

Nevertheless, some of the recommendations contained in this report may appear at first glance to be too severe or too sweeping. Yet the steps recommended in this report are necessary, given the magnitude of the challenge facing the department and the City, and considering those challenges in conjunction with information gathered during interviews and site visits.

BACKGROUND

The City of Reading, Pennsylvania contracted with Management Partners to examine workflow processes throughout the Finance Department. This engagement is part of a larger review, funded by the Commonwealth, to help the City and Berks County devise strategies that strengthen their ability to address both current and future financial challenges. Furthermore, the City wants to identify measures that ensure it has the overall financial stability to provide residents and business owners with dependable, high-quality public services.

Thus, the objective of this particular review is to examine existing operating practices, policies, and protocols in the Finance Department, and to recommend changes that improve efficiency or reduce operating costs.

METHODOLOGY

The Finance Department review was conducted using direct interviews with key staff, including division managers and front-line supervisors. A series of focus groups were held with line staff to elicit their perception of operational strengths and weaknesses. Other individual meetings took place with the City's Managing Director, the Finance Director, the Information Technology Director, the local union president, and the Director of the Berks Earned Income Tax (EIT) Bureau.

Documents pertaining to the Finance Department and its divisions were reviewed to determine which policies, practices, and procedures governed the day-to-day finance functions. We also reviewed the Finance Department's budget and organizational charts.

After reviewing all this assembled information, we made additional site visits. The remaining questions about finance operations were answered via questionnaires, telephone calls, and e-mail correspondence.

Management Partners staff also spoke with a representative of Wachovia – the City's lockbox service provider – and discussed the bank's experience with lockbox operations, both with the City of Reading and with other clients.

Management Partners defined suitable characteristics to use when matching the City with a representative group of municipal peers. The City also provided input into the process of defining a peer group of Pennsylvania municipalities – those similar in size, budget, and general socio-economic features. The peer group included Allentown, Bethlehem, Erie, Lancaster, Scranton, and York. We then requested information from these municipalities about their finance operations. Additional information about the peer cities was gleaned from the Pennsylvania database for municipalities' Comprehensive Annual Financial Report (CAFR).

Finally, the information was collated and organized into the format presented in this report.

OVERVIEW

The Reading Finance Department consists of the following divisions (shown with 2005 budget amounts and staff levels) in **Table 1** below.

TABLE NO. 1: FINANCE DEPARTMENT 2005 STAFFING AND BUDGET

Fiscal Year 2005		
Division*	*Staff Positions*	*Budget*
Administration	4.0	$225,426.55
Accounting	5.0	$241,640.56
Tax Administration	14.0	$702,295.68
Treasury	3.0	$161,127.17
Purchasing	2.0	$382,080.23
Mailroom	0.5	$202,696.17
Budget Management	0.5	$ 40,898.04
Total	**29.0**	**$1,956,164.40**

*Division names are as shown in City documents for this budget year.

Funding for this department is derived wholly from the City's General Fund. The 2005 budget amount is $751,521 lower than the 2004 budget amount of $2,707,685.   The lower 2005 budget amount is primarily because the Information Technology Department was transferred to the Managing Director's budget.

In 2005, 29 full-time employees were assigned to Finance Department operations. Temporary workers are hired in the first few months of the year to help with data entry during the income tax filing season (February through early May). All non-management employees belong to the American Federation of State, County and Municipal Employees (AFSCME) union.

The recently-approved 2006 staff levels and budget for the Finance Department are shown below in **Table 2.**

TABLE NO. 2: FINANCE DEPARTMENT 2006 STAFFING AND BUDGET

Fiscal Year 2006		
Division*	Staff Positions	Budget
Director of Finance	5.0	$298,840.81
Accounting & Fiscal Management	5.0	$291,572.65
Tax Administration	14.0	$901,215.35
Treasurer	4.0	$211,516.36
Purchasing	1.0	$354,397.52
Mailroom	0.5	$186,994.07
Budget Administration	0.5	$ 36,374.93
Total	30.0	$2,280,911.69

*Division names are as shown in City documents for this budget year.

The department's 2006 expenses are projected to rise by 16.6% over 2005 expenses. Staffing will increase by a net of one position. No other major changes are planned.

Office space for the different divisions is in different areas of City Hall. Communications and data lines (telephone and computer networks) link the different divisions, both with each other and with other City departments. In 2003, new Windows-based financial management software (Hansen) replaced the City's former mainframe-based software to enhance the City's financial management capabilities.

ADMINISTRATION

The Administration Division oversees all Finance Department operations, and it provides administrative support and management for all department divisions. This division identifies and schedules necessary training for department staff, prepares financial reports for the City's Managing Director, Mayor, and Council; monitors overall compliance with the adopted City budget; and analyzes and recommends efficiencies in financial management for City departments.

According to 2006 staffing authorizations, division staff includes the Finance Director, one confidential secretary, one grant writer, and two finance floaters (who are assigned to a variety of tasks in the Finance Department on an as-needed basis).

The Division operated without a designated Finance Director from April 2005 to January 2006. When the Finance Director position became vacant in April 2005, the Purchasing Manager at that time was appointed as Acting Finance Director. The Purchasing Manager position was left unfilled during the 2005 budget year. (The Acting Finance Director eventually recommended that the Purchasing Manager position be abolished, and the FY06 budget subsequently did not include it.) In January 2006 the Acting Finance Director was named Department Director.

In addition to managing overall operations within the entire department, Administration also is responsible for ensuring that the department provides adequate financial information and service to the Managing Director, the Mayor and Council, and City departments. As such, the Administrative Division has a unique role in coordinating and overseeing all division functions. There are several overarching duties that need to be performed well for the Finance Department – and the City – to succeed.

Analysis & Recommendations

Some important themes emerged during the course of staff interviews and focus group sessions. These themes are not tied to specific sectors or functional divisions of the Finance Department. Rather, the observations outlined below apply to all divisions in the department. Instead of repeating each observation during discussions of each

division's operations, the observations are discussed here. They apply generally to the entire Finance Department. Recommendations accompany observations as appropriate.

EXECUTIVE STAFF MEETINGS

No regular meetings of key department and division staff have been held during the past several years. Finance Department staff expressed concerns about past poor communication between management and line employees. During interviews, several employees indicated they felt as if management didn't know or care about how decisions would affect employee work processes.

On the positive side, many division managers expressed confidence that communication had improved over the past few months, and that it would continue to improve. Interviewees noted that the Managing Director and the recently-appointed Finance Director had been both straightforward and approachable in their capacity as managers.

The Finance Director should institute regular one-on-one meetings with executive staff to capitalize on this spirit of goodwill and cooperation, and establish a more formal structure than the ad hoc meetings currently used to address issues or problems.

> **Recommendation 1: Schedule regular meetings with key Finance Department executive staff to address work issues, problems, or changes to policies and processes.** Agendas should be prepared to focus the discussion on specific topics.

DIVISION STAFF MEETINGS

Just as important as meetings for executive staff, however, is the need for staff meetings in each Finance Department division. Information and projects discussed in the Finance Department's executive staff meetings can subsequently be discussed by each division manager during meetings with his/her own key staff.

Division staff meetings also should occur on a regular schedule, ideally taking place soon after the regularly-scheduled executive staff meetings. This tactic will help division managers convey necessary information while it is still relatively fresh in their mind.

> **Recommendation 2: Schedule regular meetings with key division staff to address work issues, problems, or changes to policies and processes.**

HANSEN USER GROUP AND TRAINING

During interviews and focus groups with Management Partners, staff members who use the City's Windows-based enterprise software (Hansen) almost universally expressed frustration with it. The Hansen software was installed in late 2002 and went live in 2003. Typical

comments made by City staff were that the software was not intuitive and that data entry took too long. (For example: users believe they must navigate too many screens to enter data or update information). Finance employees noted in focus groups and in individual interviews that they felt their complaints about the software went unheeded, and that they were not consulted about how they would like to enter information on various screens.

Information Technology (IT) staff responded that that the Hansen software package was installed basically as an "off-the-shelf" package, without extensive customization.

Although the Hansen conversion took place over a year ago, clearly the end users are still frustrated about perceived software problems. Resolving this issue will require open communication and cooperation. One of the first steps that should be taken is convening a user group to identify and catalogue the issues they are having with Hansen software. (It is important that members of the user group and IT staff share a basic understanding of the software's capabilities and functions, so some preliminary work may need to be done with the user group to outline Hansen's features.)

While they disagree about the functionality of the new software, every employee – from Finance and IT both – expressed willingness to identify ways to help them become more proficient in using the software. The City is fortunate to have that reservoir of goodwill available for resolving these software issues.

> **Recommendation 3: Establish a user group to identify issues with the City's current enterprise software.** The Managing Director may choose to appoint a "neutral" facilitator (at least initially) to keep the group focused on finding solutions, rather than on assigning blame or recrimination. Actions taken to resolve problems or implement suggestions, along with the results of those efforts, also should be documented and shared with the user group at regular meetings.

Additionally, deficiencies in staff training and skill sets should be identified so that employees who cannot effectively use the software will receive the training they need. IT staff indicated that every Finance Department employee did have an opportunity to attend training sessions before the system went "live."

IT staff suggested that some Finance Department employees are not comfortable using Hansen because the new software does not look the same as the software previously used by the City. The user interface screens in Hansen are different because Hansen is based on a graphic user interface platform (Windows).

>**Recommendation 4: Assess the skills of Finance employees who use Hansen software and require those who need it to receive additional training on the software.**

PROBLEM-REPORTING PROTOCOL

Problems occur with many major software conversions. In most cases, initial conversion problems can be corrected by consulting with the software vendor or by modifying procedures. However, a year after the conversion to Hansen, those who use it still report problems with the software.

At this point, ongoing problems need to be identified so that appropriate solutions can be developed and applied. The challenge with the Finance and IT Departments is that communication has been strained because of past problems with the software rollout.

IT staff noted that they typically hear about complaints informally, if at all. One example given was that an IT staff member happened to take a work break and overheard one employee complaining to a co-worker about a software problem. The IT staff member was able to correct the problem almost immediately once he learned of it, but nothing had been relayed to him about the problem before that serendipitous work break.

Yet thus far no formal protocol has been created or implemented for employees to report software problems, or for IT staff to record what action was taken to correct the reported problems.

>**Recommendation 5: Create and implement a formal protocol to report, record, and resolve user problems with Hansen software.** Hansen system users should be required to report problems they encounter while using the software. A standardized reporting and tracking mechanism (either e-mail or paper-based) would help IT staff and management monitor problems more effectively and develop appropriate solutions.

INTER-DEPARTMENTAL CUSTOMER SERVICE

The Finance Department would benefit by establishing an inter-departmental "users group" composed of Finance staff and internal customers served by the Department. The user group would provide a platform for addressing emerging problems or concerns between the Finance Department and other City departments.

>**Recommendation 6: Convene a users group of Finance staff and internal customers to identify problems and recommend possible solutions.** Similar to the staff meeting recommendation, a record should be kept of work assignments to monitor results.

Recommendation 7: Develop a mechanism to obtain periodic feedback from City staff in other departments who rely on the Finance Department for information or service. Tracking the level of customer service satisfaction is a local government best practice. Although Finance Department customers are primarily internal ones (i.e., other City departments and management), good service provided by the Finance Department helps other departments be successful.

ESTABLISH INTERNAL PERFORMANCE MEASURES AND BENCHMARKS

"What gets measured gets done." – This old adage aptly illustrates the rationale that underlies the establishment and implementation of performance measures. Whether it refers to how many tax returns are processed, or how many cash receipts are reconciled, or any other defined and quantifiable task, measuring performance helps define an internal benchmark (or standard) that is used to gauge satisfactory work. Unfortunately, the Finance Department does not have a defined set of performance measures, nor is there a historical set of performance data available to readily create such measures.

The Governmental Accounting Standards Board (GASB) recommends performance measures as a best practice for local government. The lack of an objective standard makes it more difficult to determine which employees provide superior services and which ones do not. Without performance measures, managers do not have an objective tool to use when evaluating employees. Finally, accurately assessing workflow processes is problematic without good, reliable data on past and current performance.

Each division in the Finance Department should begin tracking data on key functions for each employee. These indicators should include the number of items processed, the time it takes to process each item, the error rate during processing, etc. Although it takes time to develop and record consistent measures, the payoff will be realized in management's enhanced ability to make informed and objective decisions.

Recommendation 8: Define internal benchmarks and implement the use of performance measures as a way of managing and tracking the work of the department. Performance measures can help assess the efficiency of the Finance Department's staff and gauge the effectiveness of the department's current workflow.

FINANCIAL FORECASTING

One primary Finance Administration responsibility is to forecast the City's long-term financial condition. This responsibility takes on added importance given the City's current poor fiscal health. According to the Mayor's FY05 budget message and City staff, the City faces a number of significant fiscal challenges during the next few years. Those include

declining property values; replacing revenue transferred from sewer operations in prior years, but now prohibited under a consent decree with the United States Environmental Protection Agency (USEPA); and rising labor costs.

Meeting these challenges successfully depends on how well the Finance Department reliably predicts the impact of policy and program changes, and anticipates changes in local economic conditions -- both of which will affect the City's future revenue collections and expenditures.

Developing and using a sound financial forecasting model helps the City estimate future revenue and expenditures for each budget year. Financial forecasting also is a best practice endorsed by the Government Finance Officers Association (GFOA).

As part of the overall Management Partners scope of services, a financial forecasting model has been developed (the model is presented in a separate report). The Finance Department should use the financial forecasting model to provide accurate and comprehensive predictions of the City's ongoing fiscal health.

> **Recommendation 9: Use the financial forecasting model developed by Management Partners to monitor key indicators and regularly assess the City's short-term and long-term fiscal health**. The model should be used during annual budget deliberations to help guide decisions on City services, programs, and staffing levels. Tracking and reporting on the variables in the model will yield important information on trends and patterns that affect the City's revenue and expenses. Decision makers then may use this information to guide discussions on appropriate tax rates, service levels, and staffing requirements.

MONTHLY BUDGET MONITORING

Another important Administration responsibility is monitoring each year's adopted budget and identifying variances. Although Pennsylvania law requires the City to adopt a balanced budget, during the budget year the City's financial circumstances may change – sometimes dramatically.

For example, the 2004 budget was balanced on paper, but the revenue budgeted for that year did not come in as projected. According to the Mayor's 2005 budget message, in FY04 the City received approximately $836,000 less revenue than budgeted.

Additional examples highlighting the importance of budget monitoring are contained in an analysis performed last year by the Pennsylvania Economy League (PEL). The PEL analysis indicated that the City's revenue shortfall in 2004 occurred because the City's number of tax-exempt properties increased, overall property values were slowly declining, delinquent tax collection rates were overestimated, and interest

earnings had been inflated. The PEL report also noted that the City underestimated expenditures in 2004. Instead of the $48.67 million budgeted, PEL suggested that $50.01 million would have been a more accurate projection of 2004 expenditures.

Sound budget monitoring practices would have helped identify these trends and map out strategies to address them. However, the Finance Department has not developed or used a formal system of tracking financial indicators that identifies negative trends, and that warns executive management and policymakers of potential adverse consequences.

Monthly reporting on budget variances for both revenue and expenses would keep management and elected officials apprised of the City's financial condition. Some of the indicators tracked and reported in each period should include:

- Revenue collected by each function or enterprise activity (building permit fees, water and sewer fees, court fines, etc.).
- Expenditures incurred by each department or cost center (overtime, fuel costs, commodities and supply costs, etc.).
- Variance from budgeted amounts.
- Percentage of the annual budget expended or remaining for each department or cost center.
- Comparison of current year revenue and expenditures with the preceding year's budget.

If revenue is collected more slowly than expected, or expenses are rising faster than expected, the monthly reports would show those trends. The Finance Department also can analyze those trends to provide guidance to the City administration and elected officials. This would enable City leaders and managers to make changes when problems first begin to emerge, and thus head off bigger problems in the future.

> **Recommendation 10: Monitor and report monthly budget information to elected officials and managers.** The report also should explain any significant variances from expected year-to-date budget amounts.

REPORTS & CHARTS

Some staff noted that while some financial information was available via the City's enterprise software (Hansen), that information was in raw form only and was not easily useable. Ideally, information should be reported clearly and concisely so that staff in other departments can understand it and use it effectively.

Crystal Reports is one software package that can be used to gather data and to design reports using a wide range of data sources (Microsoft SQL, Microsoft Access, Microsoft Excel, Oracle, and text files, to name a few). Crystal Reports can take raw data and tailor it into graphically oriented

charts and other easily-understood information to meet each department's specific management needs.

> **Recommendation 11: Collate financial data from multiple sources and present that information graphically in a clear and concise format.**

DEPARTMENT PERFORMANCE PLAN

The Finance Director has a special responsibility to direct the overall activities of his department. He should set goals and objectives to help focus his staff on desired outcomes, which also will help define work priorities. Department goals and objectives have not yet been developed, nor have work plans been developed for the department's major tasks. Taken together, these individual work plans would constitute the department's overall "performance plan." The performance plan will serve as a template for the department's activities. Key staff will better understand the department's goals, priorities, and expectations.

The Finance Director indicates that he intends to pursue this strategy with key members of the Finance Department and in consultation with the City's Managing Director. Allocating the time necessary to develop those work plans may be a challenge, but the payoff will be worth the effort. Once developed, the department's performance plan will guide ongoing activities and provide a gauge for measuring results.

> **Recommendation 12: Work with key staff to create work plans based upon desired departmental outcomes.** Ensure that the work plans fit the Finance Department's overall goals and objectives, and that the individual work plans can be integrated into the department's performance plan.

DOCUMENTING EXECUTIVE STAFF MEETINGS

As discussed previously in this section, regular staff meetings will promote good lines of communication. This item bears repeating because the Finance Director is responsible for ensuring that his department performs effectively.

Although the Finance Director reports that he has periodically met with key department and division staff members, no written records are kept of what work is assigned, to whom it is assigned, and when it is due. One way to increase the accountability and productivity of Finance staff is to record and track work assignments. This way, the Finance Director and his division managers and employees will have the same understanding about work assignments.

> **Recommendation 13: Keep notes of work assignments and completion dates so that management can gauge performance on assigned tasks and can address problems as necessary.**

CROSS-TRAINING STAFF

The last item discussed for Administration is the allocation of work. Staff interviews identified a series of vacancies within the Administration Division (as well as in other Finance divisions). As a result of those vacancies, the remaining Finance Administration staff has had to cover multiple responsibilities. Other tasks subsequently suffered – for example, regular financial reports were not generated, and federal grant projects were not closed out when completed. Also, audit findings were issued in 2004 for lack of timely payment postings and a bank account was opened without proper authorization.

The Finance Director indicates that his department staffing levels are nearly up to strength. Nonetheless, some staff should be cross-trained to help relieve the burden of short-term staff shortages.

> **Recommendation 14: Define key jobs in the Finance Administration division and identify other Finance staff within the department who can be cross-trained on those job functions.** The union contract will need to be reviewed for guidance on the amount of cross-training permitted in the Administration division. Contract changes should be proposed as necessary to ensure that cross-training takes place.

TAX ADMINISTRATION

The Tax Administration Division is the largest component of the Finance Department. The division bills and collects all taxes levied by the City of Reading and the Reading School District. The Tax Administration Division administers the amusement/admissions tax, business privilege tax (BPT), earned income tax (EIT), emergency & medical services tax (EMST), per capita tax (PCT), real estate taxes for properties within the City, and other City license or user fees. The division also keeps taxpayer records on all individuals living within the City and on all businesses operating within the City (including self-employed individuals).

The 2006 budget includes funding for the following staff: a budget/tax manager (½ position), one tax supervisor, two tax examiners, one EIT analyst, one accounts coordinator, one secretary, one delinquent tax collector, five tax clerk II positions, a mailroom/tax clerk (½ position), and one clerk/typist II.

The Budget/Tax Manager has managed the division since March 2005. She not only oversees the Tax Administration Division, she also is responsible for preparing the City's annual budget. One-half her time is allocated to managing the Tax Administration Division; the other half is allocated to the budget function. In practice she spends 65% - 70% of her time overseeing the tax administration function.

Analysis & Recommendations

This section is broken into four separate parts:
- The first part briefly describes the current mood in the Pennsylvania statehouse regarding Act 511 tax collections.
- The second part deals with the Finance Department's Tax Administration operations.
- The third part deals with Berks Earned Income Tax (EIT) Bureau, a private tax-collection agency serving nearly all the political jurisdictions in the County (including most school districts).
- The fourth part addresses overall tax collection issues for both the City and the Berks EIT Bureau.

CONSOLIDATING ACT 511 TAX COLLECTIONS

Today's incarnation of Pennsylvania's local tax system dates back to the mid-1960s, when the state legislature adopted Act 511. Under that Act, virtually all the state's local jurisdictions – including school districts – could levy taxes on multiple sources. Although Act 511 didn't cover real property taxation, it did allow amusement taxes, mercantile taxes, mechanical devises taxes, occupational taxes, occupational privilege taxes, and per capita taxes. (In recent years, however, the state has limited Act 511 taxing authority, particularly for school districts.) Over the past 40 years, many local governments and private agencies have assumed a role in collecting Act 511 taxes.

In March 2004 the Governor's Center issued a strongly worded report criticizing the patchwork of hundreds of different Act 511 income tax collectors throughout the state. In particular, the report cited multiple examples of inefficient and ineffective income tax collection, and the call to reform was loud and clear.

One option was to eliminate all local income tax collections. Instead, the state would collect income taxes and remit them back to local governments and school districts. Another option lauded by the Governor's Center was to allow only one tax collection entity in each county. Examples of this type of proposal already exist in several central Pennsylvania counties.

State legislators have not yet reached consensus on how to reform Pennsylvania's tax collection system. Nonetheless, legislators have been considering the issue ever since the Governor's Center report was issued. Based upon reactions to the report and subsequent discussions in the legislature, it appears likely that some levels of the tax collection system will be consolidated.

This issue is important because it has long-term implications for the City. The state may decide to restrict the number of Act 511 tax collectors in a county. The state also may choose to eliminate or radically reduce the permissible rates and types of Act 511 taxes that local jurisdictions can levy. Lastly, the state may mandate that it is the only entity authorized to collect earned income taxes (which it probably would redistribute back to local jurisdictions). Each of these scenarios would dramatically change the City's role in collecting Act 511 taxes.

READING TAX ADMINISTRATION

The Tax Administration Division offices contain stacks of tax bills, returns, and account statements that line the walls and cover nearly all flat surfaces. Division staff estimated the number of pieces to be in the thousands. It was impossible to determine just how many were unopened; how many had been partially processed, but were unfinished; or how many were finished and waiting to be filed.

The problem with such conditions is that when tax bills, returns, or account statements are disorganized, the City likely is not processing items in a timely or efficient manner. Important tax information and other data could get misplaced or lost. This type of environment is not conducive to maximizing revenue opportunities. The Budget/Tax Manager acknowledged that the division's paper files needed to be organized.

City staff suggested that the filing backlog began in 2004, and resulted partly because five staff positions were eliminated after the City outsourced lockbox operations to Wachovia. Staff also indicated that the backlog became acute later in 2004, shortly after the new Hansen software system was implemented. According to division staff, the combination of lockbox staff reductions and the rollout of an unfamiliar software program caused employees to fall behind in their processing and filing of tax forms. By the beginning of 2005, the new tax collection season began and more tax forms started to come in.

However, the Finance Director noted that only two staff positions were proposed to be eliminated as a direct result of outsourcing lockbox. Of those two positions only one was actually vacated (the other employee was reassigned after filing a grievance on the matter). The remaining four positions were eliminated due to various reasons before the Finance Director's tenure with the City.

Regardless of the initial cause, the critical need now is to allocate staff resources for organizing the files. Current staff still are busy trying to process last year's tax forms, and another tax season is about to begin once again. Organizing the files during the next two or three months will have a significant positive effect on staff performance and morale – not to mention implementing a records management best practice.

> **Recommendation 15: Hire experienced temporary employees to sort out the Tax Administration Division's files within the next three months.** The temporary workers must be able to both work independently and also cooperate with division staff on records management issues.

Also of note was the proximity of the front-counter to tax clerk desks. For all but two work areas, no physical separation existed between Tax Administration employees and the customer-service area at the front counter. It seemed apparent that tax clerks are frequently interrupted by front counter activities, regardless of what other tasks they are doing.

> **Recommendation 16: Develop a plan with assistance from the City's building/facilities manager on how to reconfigure the office layout and create less distracting, more efficient employee work areas while also preserving the ability to provide satisfactory service to walk-up customers.**

MAJOR TYPES OF TAXES COLLECTED

The City levies five key taxes. The City's Act 511 taxes are the business privilege tax, the earned income tax, the emergency and municipal services tax, and the per capita tax. The other key tax is the real estate tax.

The Tax Administration Division collects and processes each tax. These taxes are briefly described below, including the amount collected; the staffing requirements and costs of collection; issues associated with collecting the tax; and recommendations offered to improve the collection process.

Business Privilege Tax (BPT)

The BPT can be either a flat rate or a proportional tax levied on the gross receipts of workers employed in certain occupations, trades and professions. The BPT also may be collected from merchants, vendors, and others for the privilege of doing business within the City.

According to City records, the BPT amount collected in 2004 was $1,263,981. This amount has remained fairly stable over the past five years.

Any person or company conducting business in the City must first obtain a Business Privilege License. The license is renewable annually by the business owner (non-profits are exempt). Once the business owner files an application, the information is entered into the system and a unique identification number is assigned. The City mails tax forms to businesses on record with the City. Businesses must file their BPT return by April 15 each year, which is near the same time other major City taxes are due.

The BPT Process is depicted here in **Figure 1**.

FIGURE 1: BUSINESS PRIVILEGE TAX PROCESS

City of Reading / Finance Department – BPT Process
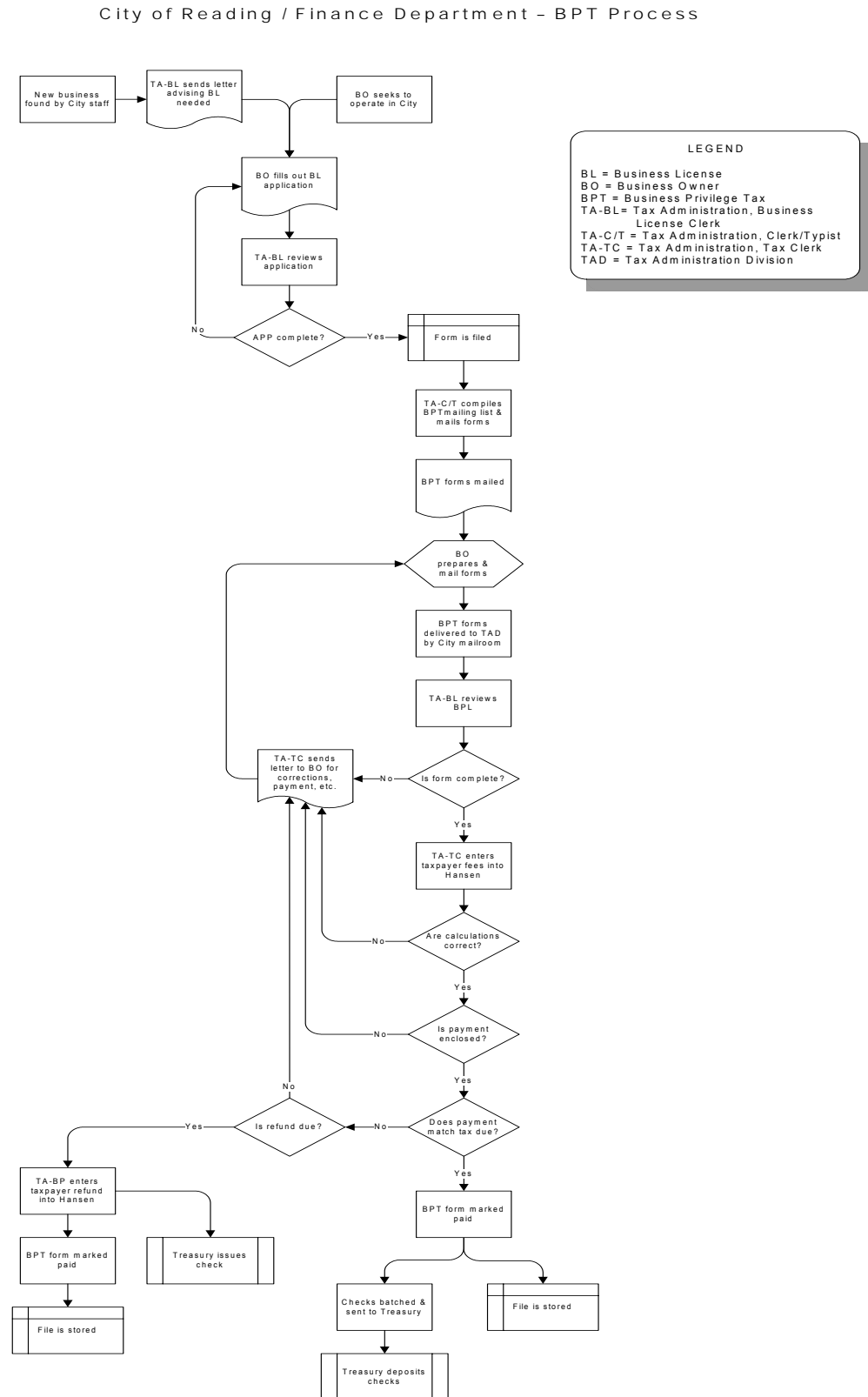
The BPT Tax Clerk keeps the BPT paper returns in chronological order in a box. Businesses operating without a license – and thus that do not pay BPT – are discovered only by chance, such as when a police officer or code enforcement inspector notices a new business operating within the City and reports it to the division's Tax Examiner.

Another way of finding unlicensed businesses is when the Tax Examiner periodically canvasses sections of the City looking for new businesses that have not yet obtained a license. That method is time-consuming, though, and relies on the Tax Examiner's keen eye and memory to be successful.

The division does not keep data on how many businesses pay the BPT. Delinquencies currently are not tracked or reported.

One tax clerk is assigned to BPT, and about 65% of that employee's time is spent processing Business Privilege License applications and the BPT. Data entry occurs daily, but during peak tax season the information may not be entered for 30 days or more. The Finance Director estimated the direct salary and benefit cost of collecting this tax is $26,421.

The following recommendations are made to improve the workflow in collecting and processing the BPT:

Recommendation 17: Measure current data entry performance and use results to establish desired internal benchmarks for employees who process BPT. This concept has already been discussed in the "benchmarks" text of the _Administration_ section, but it bears repeating here. See also Table 3 on page 32.

Recommendation 18: Change the BPT due date to minimize scheduling conflicts with other taxes collected and processed by the Tax Administration Division.

Recommendation 19: Establish a tracking system to record when returns are filed with the City, when they are processed, and when the BPT is shown as paid in the City system. Delinquency reports then can be generated and used to identify problems. Hansen software should be able to handle this task.

Recommendation 20: Train City workers who travel throughout the City – police officers, water utility workers, parking meter personnel, code enforcement inspectors, etc. – to call in new businesses to the BPT Tax Clerk.

Recommendation 21: Use business license information available from the Pennsylvania Department of State and the Department of Revenue to identify unlicensed businesses operating in the City. It would be useful to request notification from the Pennsylvania Department of State when a business with a Reading address registers with the state. The State Department of Revenue also may be able to provide information on new Reading businesses.

Earned Income Tax (EIT)
The EIT is a proportional tax levied on the wages, salaries, commissions, net profits, or other compensation earned by City residents. City residents are required to pay a City income tax of 1.7%. (The City increased the rate from 1.5% for the 2005 tax year.)

The amount of income tax collected in 2004 was $5,964,810. This amount was 59% higher than the amount collected in 2000. The EIT process is depicted below in **Figure 2**.

FIGURE 2: EARNED INCOME TAX PROCESS

City of Reading / Finance Department – EIT Process
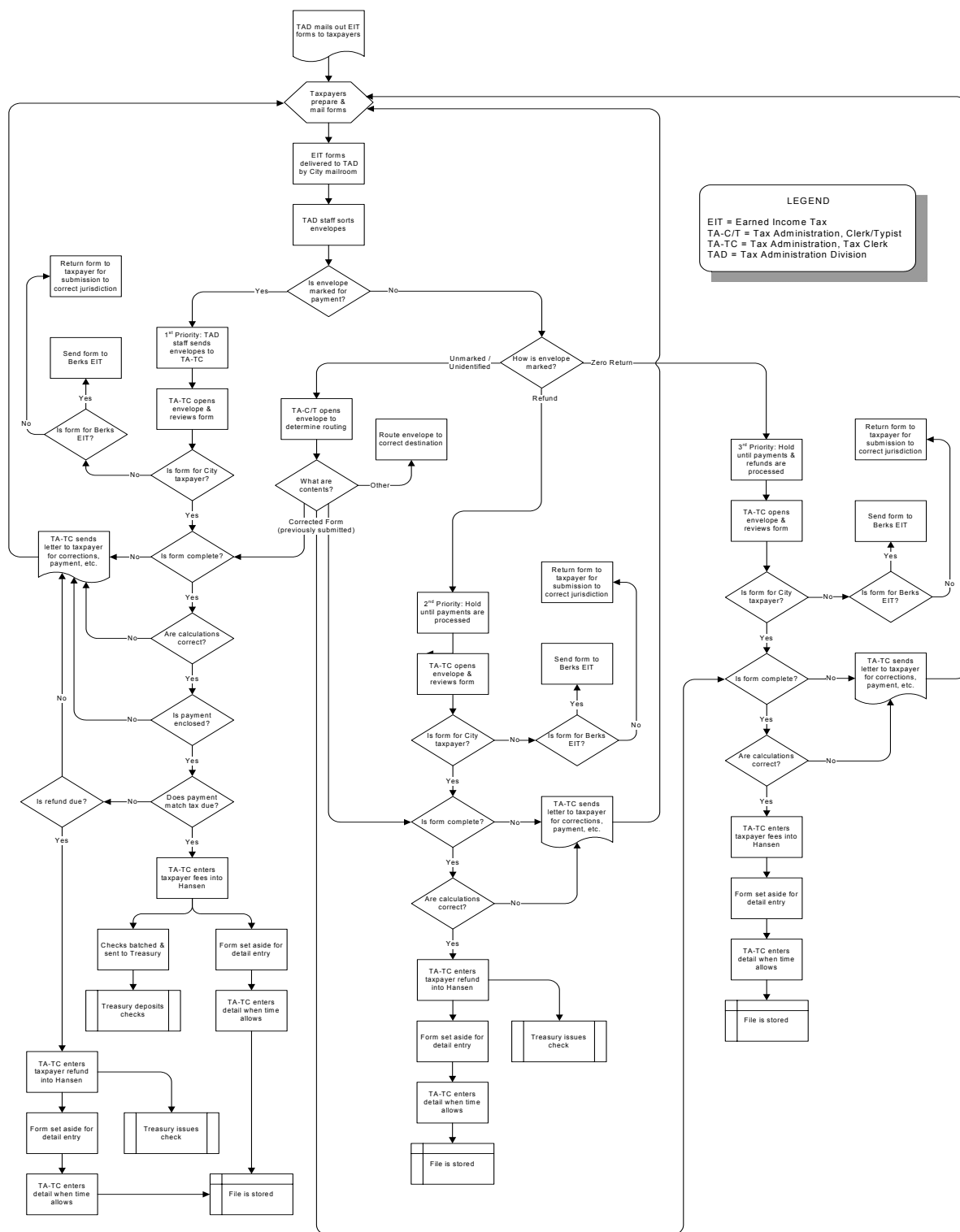
Employers located in or operating in Reading are required to file earnings tax reports for all employees. The reports may be on electronic, paper or magnetic tape media, but they must include employee names, annual earnings, and taxes withholdings.

In 2004 about 1,518 businesses filed employee information with the City, which was about 30% lower than the number of businesses filing employee information in 2000 (although the 2000 numbers include *all* employers operating in the City, not just those employers who filed tax information regarding their employees). The reports also must be filed monthly or quarterly, even though staff does not use those monthly or quarterly reports. Staff relies only on the final record sent by the employer to determine who owes City income taxes.

Each individual taxpayer is assigned a unique identification number referred to as the "AP Number." The City mails out pre-printed forms to the individual taxpayers it has on file, and makes blank forms available at tax preparation centers and on the City website. (According to staff, the tax forms change from year to year, and businesses have expressed dissatisfaction with the short notice provided before the changes took effect.) EIT data was not collected in prior years, nor was any information collected to distinguish between new and existing income taxpayers.

In 2005 the City received an estimated 21,000 individual tax returns. Returns are processed on a "first in, first out" basis. The division's clerk/typist entered information into the system, taking an average of one minute to enter the fees and another 90 seconds to enter the detail (taxpayer name, address, employer, etc.). During tax season, the clerk/typist devotes approximately 85% of her time entering information about employers and individual tax payers.

One full-time tax clerk and several interns are assigned to check individual tax returns for accuracy and process payments or refunds. The full-time tax clerk also is expected to answer phones and help with front-counter customer service duties while still processing returns.

The tax clerk spends approximately 80% of her time processing returns, and interns spend 100% of their time processing returns. Each return takes an average of five minutes to process (assuming no interruptions).

The Delinquent Tax Collector currently uses old pre-Hansen-conversion reports to identify delinquent taxpayers. These delinquency reports are now over a year old.

Tax Administration employees work only 35 hours per week, per the current union contract, with no mandatory overtime required – even during tax season. The Finance Director estimated the direct salary and benefit cost (including hiring interns during tax season) of collecting this tax is $115,598.

The following recommendations are made to improve the workflow in collecting and processing the EIT:

Recommendation 22: Measure current data entry performance and use results to establish desired internal benchmarks for employees who process EIT. This concept has already been discussed in the "benchmarks" text of the _Administration_ section, but it bears repeating here. See also Table 3 on page 32.

Recommendation 23: Require Tax Administration employees to work mandatory overtime during tax season. The union contract may limit or constrain how management assigns overtime. If so, the contract should be amended to allow for mandatory overtime during tax season.

Recommendation 24: Negotiate a change in the union contract to increase the standard workweek to 40 hours per week.

Recommendation 25: Use a consistent format for EIT forms from year to year.

Recommendation 26: Eliminate the monthly and quarterly EIT reporting currently required of businesses. The City relies solely on EIT data supplied by businesses at the end of the year. Requiring the data quarterly or monthly is not productive for businesses or for the City. (And the City also can tout this "business friendly" change as a way to improve the perception of the business climate in Reading.) If eliminating the quarterly and monthly EIT reports is not an option, the City needs to find a productive use for those reports – like setting up new files when a new employee begins working at a business located in the City. That step should save time when tax returns are processed in the following tax year.

Recommendation 27: Obtain taxpayer records from the Pennsylvania Department of Revenue and use those records to cross-check City tax returns. Section 356 of the Tax Reform Code allows the City to obtain taxpayer records from the Pennsylvania Department of Revenue (DOR). DOR charges jurisdictions a minor fee for producing the information depending upon the format desired (paper copies, CDs, magnetic disks, etc.)

Recommendation 28: Review and "clean" the EIT list of taxpayers annually, thereby reducing duplicative entries and undeliverable forms. Once an accurate list is established it will be easier to verify the accuracy of taxpayer information in future years. The City's Managing Director reports that the IT Department already is working on this task.

Emergency & Municipal Services Tax (EMST)
The EMST is a tax on the privilege of working in the City. This tax previously was called the Occupational Privilege Tax (OPT) and was capped at $10 per year. In 2005 the state legislature replaced the OPT with the EMST and allowed jurisdictions to levy a maximum EMST of $52 per year. EMST revenue helps pay for the City services used directly or indirectly by those who work in the City. Everyone who works in the City must pay this tax, regardless of whether they live in the City.

The City collected $207,233 in EMST for 2004. That amount has remained fairly steady over the past five years.

The process for collecting EMST payments is depicted in **Figure 3**.

FIGURE 3: EMERGENCY AND MUNICIPAL SERVICES TAX PROCESS

City of Reading / Finance Department – EMST Process
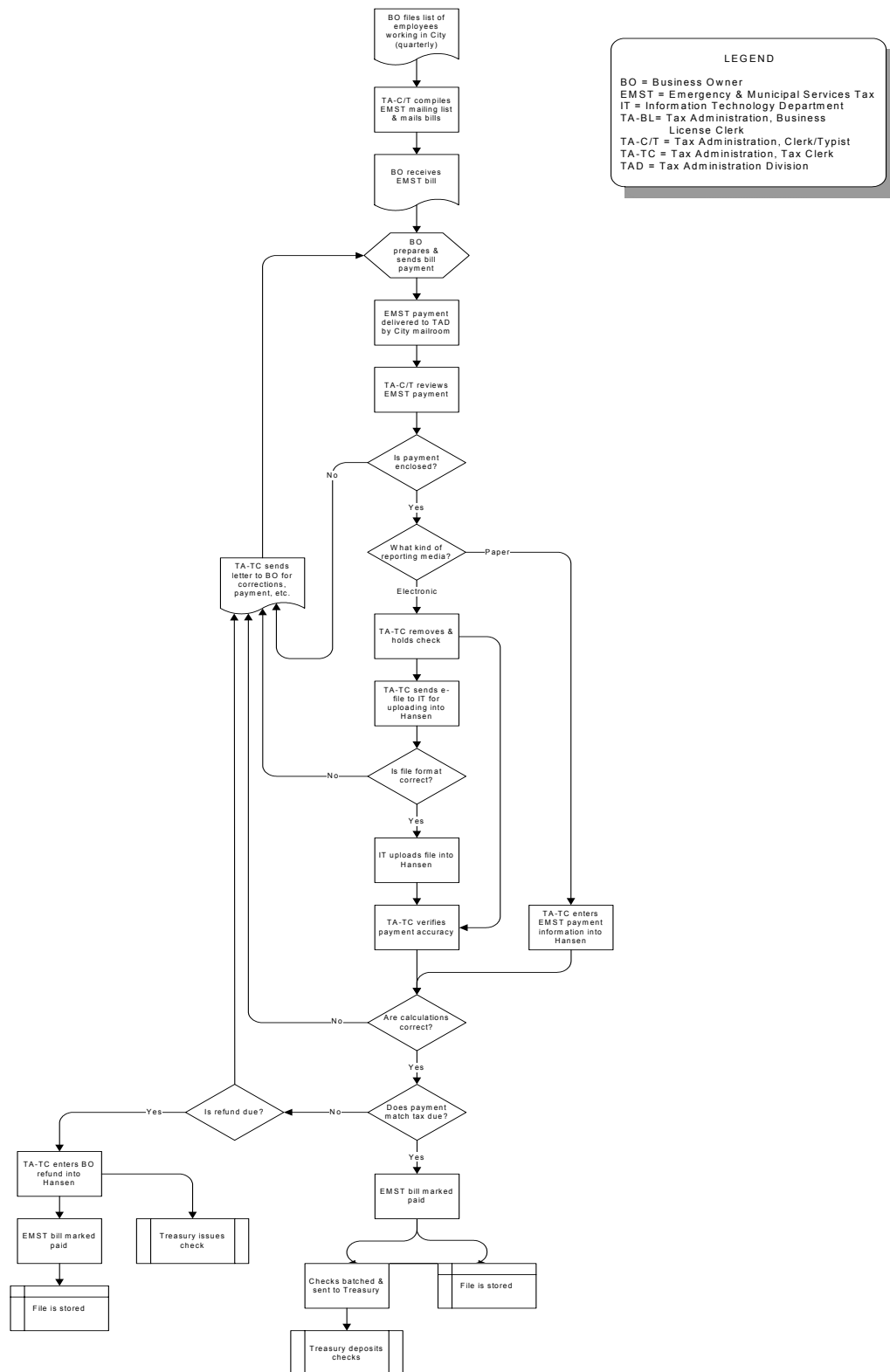
To collect the tax, the City sends EMST filing notices to employers located in or operating in the City. Employers then must remit quarterly tax payments for each employee working within the City limits. Smaller companies file EMST via paper forms, which take significantly more staff time to process than electronic files require.

Beginning in 2006, businesses that employ *more* than 49 workers will be required to submit EMST information electronically via e-mail or a diskette. Businesses with 49 or fewer employees may still choose to submit records via paper media.

EMST payments are manually reviewed by Tax Administration staff for accuracy, particularly for whether the number of employees multiplied by $52 matches the amount of the check accompanying the EMST bill. Annual changes to existing EMST records are noted to be relatively rare (around 3%). Delinquent payers are identified via departmental audits or by manual reconciliations. No performance data are collected regarding the number of EMST payments processed by division staff.

Tax Administration staff who are involved in EMST processing include a tax clerk (approximately 35% of this position's time) and the clerk/typist (5% of this position's time). The Finance Director estimated the direct salary and benefit cost of collecting this tax is $16,288.

The following recommendations are made to improve the workflow in collecting and processing the EMST:

> **Recommendation 29: Measure current data entry performance and use results to establish desired internal benchmarks for employees who process EMST.** This concept has already been discussed in the "benchmarks" text of the *Administration* section, but it bears repeating here. See also Table 3 on page 32.

> **Recommendation 30: Cross-reference the City's EMST records annually with BPT and EIT records to identify those who have failed to pay the EMST.**

> **Recommendation 31: Offer an incentive – perhaps a discount – for small businesses to submit their EMST information electronically.** Processing paper tax bills requires more staff time to process and therefore costs more to collect. Reducing the number of paper transactions would save the City money.
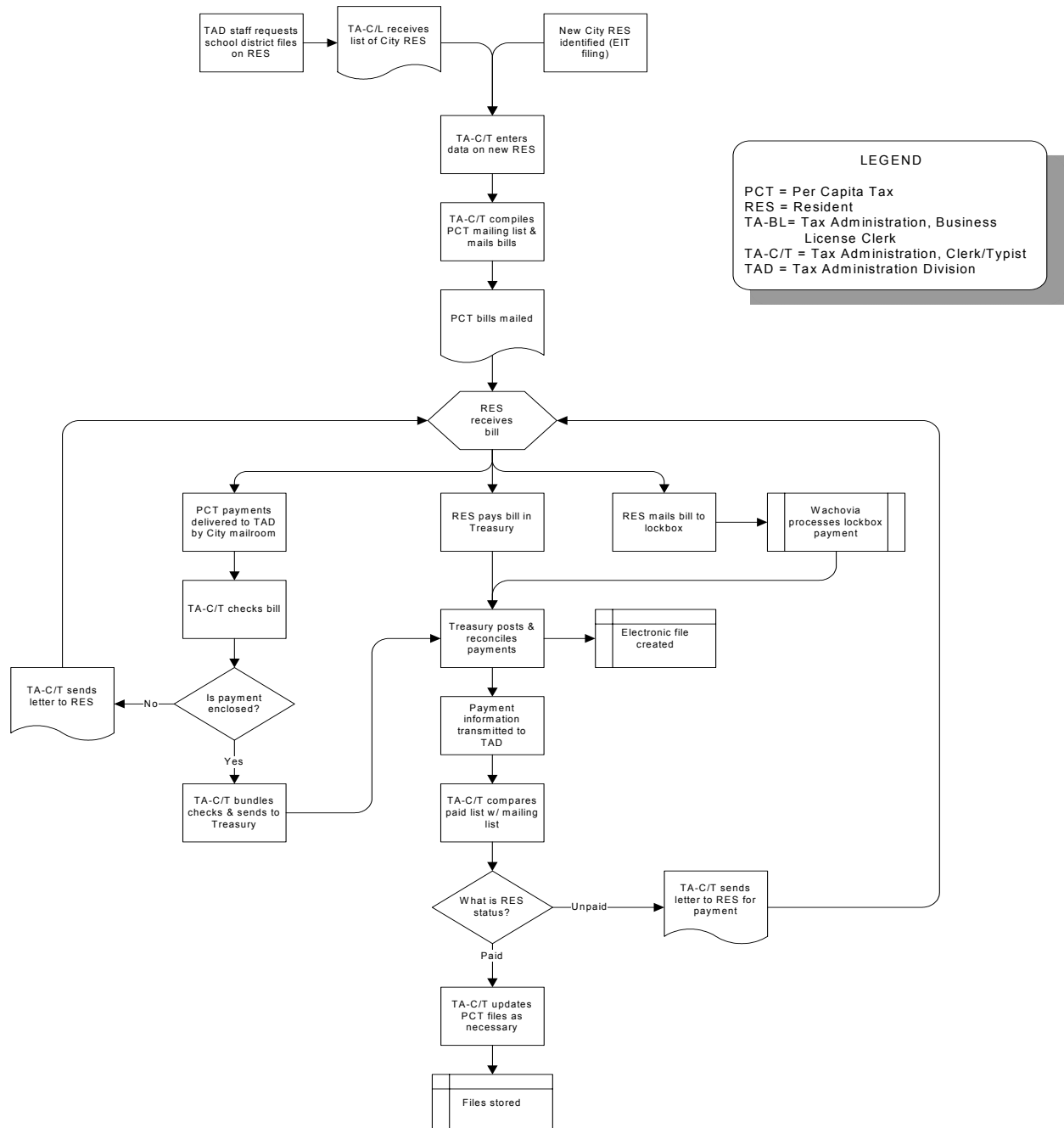
Per Capita Tax (PCT)
The per capita tax is a flat rate tax levied on adults who live in the City. All adult City residents pay the same $15 tax, regardless of income. The City also collects the Reading School District's Per Capita tax.

In 2004 the City collected PCT totaling $88,998 (this amount does not include the school district's Per Capita tax collections). That collection amount is 33.6% lower than the amount collected in 2000. The City's population during that five-year period remained relatively stable, so the revenue stream should have remained relatively constant, but it did not. The City does not reconcile changes in PCT files from year to year, so the reason for the revenue decline cannot be pinpointed.

The process used for collecting per capita tax is shown in **Figure 4**.

FIGURE 4: PER CAPITA TAX PROCESS

City of Reading / Finance Department – PCT Process

LEGEND

PCT = Per Capita Tax
RES = Resident
TA-BL = Tax Administration, Business
License Clerk
TA-C/T = Tax Administration, Clerk/Typist
TAD = Tax Administration Division

The City maintains a PCT list of all City residents that it has compiled from prior-year EIT return filings and current-year data supplied by local schools. New PCT taxpayers are added to the database whenever a business files information on a new EIT taxpayer with the City.

If the new taxpayer also is a new City resident, then the staff member who entered the EIT data sets up a new PCT account as well. The City assigns a unique identification number to each resident.

Every year the City mails PCT bills to all residents on the list. Residents must mail their bill stubs and payments back to the City by October 31. One tax clerk is assigned the task of manually reviewing and entering all PCT data. This employee spends approximately half his time on PCT-related tasks. The Finance Director estimated the direct salary and benefit cost of collecting this tax is $20,984. The City incurs additional costs in postage for mailing out the forms to residents, which makes the total cost for collecting this tax to approximately $30,000.

The following recommendations are made to improve the workflow in collecting and processing the PCT:

> **Recommendation 32: Measure current data entry performance and use results to establish desired internal benchmarks for employees who process PCT.** This concept has already been discussed in the "benchmarks" text of the _Administration_ section, but it bears repeating here.

> **Recommendation 33: "Clean" the PCT data annually to reduce duplication and errors.** The data should be cross-referenced with other tax data files to identify anyone missing from the City's existing PCT list.

> **Recommendation 34: Evaluate the long-term fiscal impact of eliminating the PCT.** The PCT takes a significant amount of work to administer and collect, and the City seems to realize only a modest "return on investment" (loss of staff time and office storage space). The school district also will need to be consulted, since the City collects the school system's per capita tax.

Real Property Taxes
The real property tax is a tax on the value of real property, which includes land, buildings, and other improvements. These taxes are collected from everyone who owns property in the City. Property owners pay real property taxes based upon: 1) the value of their property; and 2) the local tax rate.

For tax purposes, real estate values are determined via an assessment process that county governments conduct from time to time. If reassessments are not conducted within reasonable intervals, a property's assessed value may differ greatly from its actual market value.

The City's 2005 budget estimated property tax revenue at $15,619,950. Collections have remained fairly stable over the past five years. (Flat revenue growth is not surprising because Berks County has not reassessed real property values since 1994.)

The City's real property tax collection process is fairly straightforward and similar in most respects to other local jurisdictions. The City sends out property tax bills to property owners of record, and those owners have until an established deadline to pay the tax without penalty (in Reading's case the deadline is June 30). Those property owners with a primary mortgage on their property usually will have their taxes escrowed by their mortgage company, which in turn remits payment to the City.

Tax Administration staff receive and reconcile payments from property owners and intermediaries such as mortgage companies. Mortgage companies usually wire funds to pay taxes on multiple properties; individual tax payers usually pay via check.

Division staff enters bills and payments once the City receives them from property owners or mortgage companies. Cash and check payments then are forwarded to Treasury for deposit.

No one interviewed spoke of significant problems with the real property tax collection process. However, no internal benchmarks are used to determine how effective the City's current real property tax collection efforts are in comparison to other high-performing local governments. Furthermore, the City does not cross-reference real property tax records with other tax records (BPT, EIT, EMST or PCT). Annually cross-referencing those records would help identify tax delinquencies and would yield higher collection rates for the City's Act 511 taxes.

> **Recommendation 35: Measure current data entry performance and use results to establish desired benchmarks for processing real estate taxes.** This concept has already been discussed in the "benchmarks" text of the *Administration* section, but it bears repeating here.
>
> **Recommendation 36: Cross-reference real estate tax records annually with the City's Act 511 tax records to identify tax delinquencies.**

BERKS EIT BUREAU

In contrast to the City's Tax Administration Division, the Berks Earned Income Tax (EIT) Bureau is a private tax collection agency governed by a Board of Directors. Jurisdictions formally appoint (contract with) the EIT Bureau to collect their income taxes, and some jurisdictions (but not all) serve on the Board of Directors. The Board hires a director to manage the tax collection agency. (Coincidentally, before the current Berks EIT Director joined the Bureau in 1993 he worked for 15 years in the City's Tax Administration office.)

The Berks EIT Bureau collects and processes BPT, EIT, and EMST for 57 townships and 14 school districts in Berks County – basically all local jurisdictions that levy an income tax, except for 14 school districts and the City of Reading.

Unlike the City, however, Berks EIT does *not* collect property taxes or per capita taxes. Other notable differences are important operational ones: The Bureau's tax processing staff is non-union; tax processors work a 40-hour week; and overtime is mandatory during tax season.

TABLE NO. 3: PROCESSING COMPARISON – CITY OF READING & BERKS EIT BUREAU

Tax / Jurisdiction	Reading[†]	Berks EIT[‡]
Number of Employees (excl. Supervisors)	12	11
EIT		
Tax revenue collected	$5,964,810	$62,500,000
Number of employers filing data	1,518	6,500
Number of returns filed	21,000	120,000
Processing benchmark	1,750	10,909
BPT		
Tax revenue collected	$1,263,981	$1,200,000
Number of businesses filing data	no data	2,500
Processing benchmark	n/a	227
EMST		
Tax revenue collected	$207,233	$1,900,000
Number of businesses filing data	no data	3,000
Number of employees filed	no data	107,000
Processing benchmark	n/a	9,727

[†]*City data from 2004*   [‡]*Berks EIT data estimates for 2005 (as of 12/22/2005)*

According to the Berks Bureau Director, its EIT Bureau collected and processed about 120,000 returns during 2005, which is about the same number it processed in each of the past five years. (An important note: The Bureau accepts joint tax returns, which the City does not. The Bureau Director noted that if joint returns were separated into individual taxpayers, then the Bureau processed the equivalent of about 180,000 individual EIT returns. This is not the same, however, as actually *processing* that number of returns.) The Bureau collected approximately $62.5 million in EIT in 2005; this amount also has held fairly steady for the

past few years. The Bureau received withholding information from nearly 6,500 employers.

For EMST collections, the Bureau dealt with more than 3,000 businesses that employed 107,000 workers. The amount of EMST collected in 2005 was approximately $1.9 million.

For BPT collections, the Bureau received tax payments from about 2,500 business licensees. The BPT collected in 2005 was approximately $1.2 million.

To accomplish this collection work the Berks EIT Bureau needed 12 staff members, which includes the Bureau Director.

The total operational budget, including staff, is approximately $1 million. Each member jurisdiction pays a pro rata portion of the Bureau's budget. Two factors determine how much a jurisdiction pays for Bureau services: 1) the number of taxpayer returns the Bureau processes for a jurisdiction; and 2) the total taxes the Bureau collects for a jurisdiction. Both factors receive equal weight in the Bureau's funding formula.

OVERALL TAX COLLECTION ISSUES
The Finance Department – and, by extension, the City – has a number of issues to resolve before the Tax Administration Division begins to perform its tax collection and processing functions at a high level. In the background, the Commonwealth is working toward some type of tax collection reform. It is conceivable that Pennsylvania will limit the number of Act 511 tax collectors that operate in a county.

Those circumstances alone might persuade the City and the Berks EIT Bureau to consider cooperating much more closely, or even consolidating. Two other issues to resolve also might encourage both entities to work together. Those items are discussed below.

Cooperation to Resolve Misdirected Withholdings
First, the City still holds tens of thousands of dollars in income tax withholdings that it received by mistake. In 2004, several area companies erred and sent some income tax withholdings to the City, instead of the Berks EIT Bureau. Tax Administration staff acknowledged that an as yet undetermined amount should be forwarded to the Berks EIT Bureau. However, according to the Bureau Director, the City has not yet sent those misdirected funds.

City staff said they haven't sent the funds yet because they have been unable to quantify the precise amount owed to the Bureau. Not all the returns from that year had yet been verified at the time of staff interviews. Staff attributed slower tax return processing to staffing reductions over the past five years, which staff contended were caused by the City's lockbox contract with Wachovia (which is discussed more fully in the Accounting & Fiscal Management section below) and by the conversion to Hansen software.

In any case, the Bureau Director notes that the continuing delay concerns some of his member jurisdictions. Those jurisdictions thus far have done without the tax withholdings erroneously sent to the City (which they agree was not the City's fault). Now, after several months of inaction, those jurisdictions want to know when the City will correct the error and forward the misdirected funds to the Berks EIT Bureau.

According to Act 162 (72 P.S. §5566b), the Bureau would be within its rights to submit a written claim within three years after the City first received the erroneously-submitted tax withholdings. Thus far the Director has not taken that step. He indicates he would rather work cooperatively with the City to resolve the matter quickly and amicably.

Financial Benefit for Reading Schools
The Berks Bureau Director indicates that the City charges Reading Schools 5% to collect and process the school district's earned income tax. The Director contrasted the City's rate with the Bureau's net rate of six-tenths of 1% that it charges its member school systems to collect and process school income taxes. He suggested that if the Bureau were to collect and process EIT for both the City and the school, then the Reading School District would cut its processing fees by 80%. The Bureau Director estimated the school district would realize an annual financial benefit of at least $100,000 - $120,000.

An Alternative Recommendation
Considering all these circumstances together, one option worth serious consideration is for the City to outsource the collection and processing of its BPT, EIT and EMST to the Berks EIT Bureau.

This move would effectively consolidate those tax collection functions for nearly all County jurisdictions that levy an earned income tax (or other selected Act 511 taxes). The resulting agency no doubt would achieve economies of scale for all participating jurisdictions.

Clearly, there would be multiple details to work out, including the disposition of existing City staff, the City's role on the Board of Directors, whether formal service agreements should be established and the type of form used. The City still would collect its own real estate taxes and per capita taxes, since the Berks EIT Bureau does not handle those functions.

Outsourcing collection of BPT, EIT, and EMST is estimated to save the City a minimum of $158,307 annually in direct salary and benefit costs. Eliminating the cost of paper forms, printing and mailing costs involved in collecting these taxes should save at least another $10,000 annually. The total savings from outsourcing thus approaches $170,000 each year. This represents an approximate annual savings of 18.9% in the Tax Administration division's 2006 budget.

Offsetting those savings would be revenue lost because the City does not collect its 5% fee for processing the school district's earned income taxes. (School district revenues would increase by the 4% difference between the City's fees and the EIT Bureau fees.) Also offsetting any savings, of course, would be the fee that the EIT Bureau charges for collecting and processing a jurisdiction's BPT, EIT, and EMST. The Director did not want to estimate what the City's fee might be until he had a chance to review the volume of returns and dollar amount of those returns.

> **Recommendation 37: Evaluate outsourcing with Berks EIT Bureau to collect and process the City's BPT, EIT, and EMST.** The City will still need to collect and process its PCT and real property taxes.

ACCOUNTING & FISCAL MANAGEMENT

The Accounting & Fiscal Management Division handles all City financial transactions. This division protects the City's financial assets by ensuring that internal controls for spending money follows the standards outlined in Generally Accepted Accounting Principals (GAAP). Accounting & Fiscal Management processes all City purchase orders, vendor invoices and check disbursements, and it keeps detailed records of the transactions.

The division is responsible for recording daily cash transactions, monthly entries, quarterly entries and all year-end entries. It also reconciles all account transactions and bank statements. Finally, tracking and depreciating the City's fixed assets is the Accounting & Fiscal Management Division's responsibility.

The 2006 budget includes funding for five Accounting & Fiscal Management staff positions: an accounting & treasury manager, one accountant, one payroll clerk, one revenue accountant and one accounting clerk. (Although this division is labeled "Accounting & Fiscal Management" in the 2006 budget document, the manager's title is "Accounting & Treasury Manager" in the 2006 organizational chart.)

The Accounting & Treasury Manager started working for the City in 2002 and was promoted to her current position in 2004.

Analysis & Recommendations

Although the Accounting & Fiscal Management Division and the Treasury Division are separate entities within the Finance Department, management responsibility for both functions resides with the Accounting & Treasury Manager, who devotes most of her time to the accounting function. The two departments also use different financial software packages to perform their core functions: Accounting relies on USL; Treasury uses Hansen.

ACCOUNTING SOFTWARE PRACTICES
The Accounting Division puts out a daily cash report, monthly transaction report and bank reconciliation using USL software. Interestingly, according to the Accounting & Treasury Manager, only the treasury function uses Hansen software; the accounting function uses the aforementioned USL software for general ledger entries and other accounting functions.

> **Recommendation 38: Review the USL software application to ensure it is the accounting software solution best-suited for the City.** If it does not integrate well with Hansen, the City should consider migrating to the Hansen module for financial accounting.

Regardless of whether the City continues using USL software for accounting functions, it makes sense for the Accounting & Treasury Manager to have a working knowledge of Hansen. Hansen software plays a major role in processing and recording the City's financial transactions (particularly in the Tax Administration and Treasury divisions). Surprisingly, though, the Division Manager states that she has never been trained on the Hansen software package.

> **Recommendation 39: Require the Accounting & Treasury Manager to attend training on Hansen software.**

REVIEW MANAGEMENT STRUCTURE

The Division Manager oversees both accounting and treasury functions. The Manager estimated she spends about 80% of her time managing the accounting function and 20% on treasury operations. She reported feeling as if she doesn't have enough time available to be fully engaged in both operations. The treasury function is a separate division, and has a Chief Clerk who supervises other Treasury Clerks and the daily operations.

> **Recommendation 40: Split management responsibility for the accounting and treasury functions to reduce the span of control over the accounting and treasury functions.** The Accounting Manager feels stretched too thin by the current arrangement. This has no direct costs associated with this change, since the Treasury Division already has a Chief Clerk who oversees the day-to-day operations of this function. (A similar recommendation follows in the Treasury section of this report.)

LOCKBOX PROCESSING ERRORS

In June 2004 the City contracted with Wachovia – a private-sector financial institution – to process City utility bills and other payments (excluding payments for the City's earned income tax, emergency and municipal services tax, business privilege license tax or per capita tax). Outsourcing the processing of utility bills and other payments is recognized as a best practice by the Government Finance Officers Association (GFOA). According to Wachovia representatives, the bank provides these "lockbox" payment processing services to dozens of other Pennsylvania local governments, large and small.

Before contracting with Wachovia, City staff handled all billing functions. Payments received from customers were reconciled daily and deposited with Wachovia. Just as with most commercial accounts, Wachovia would route the City's deposited customer checks back to issuing banks and

credit the City's account when funds were received. The City eliminated one staff position in the Treasury Division once the lockbox program began.

Now Wachovia prints the bills, mails them out, processes the lockbox payments it receives from the City's utility customers, and reconciles and deposits those payments to the City's bank account. The intent behind outsourcing this function was to reduce bill-payment processing time while posting funds to the City's account more quickly, all at a lower cost.

The City pays Wachovia flat monthly fees of approximately $500 for processing payments, transmitting payment data, and storing payment data on compact discs. In addition to the flat monthly fees, the City also pays Wachovia 25.5¢ (on average) per piece processed. During the 16-month period from July 2004 to October 2005, Wachovia processed, transmitted and stored payments or payment data on 169,090 transactions. The City paid approximately $60,000 to Wachovia during that time for the lockbox service.

The Accounting & Treasury Manager and the newly appointed Finance Director both expressed concern about the number of processing errors occurring each month. Wachovia processed a total of 20,639 payments with 2,092 errors during the first six months of lockbox operations (July 2004 to December 2004). That performance yielded an overall error rate of 10.1%. After subtracting out the first month's high error rate of 38.2% – which can be attributed to start-up challenges – the adjusted overall error rate for 2004 was 7.7%.

From January 2005 to October 2005 Wachovia processed 148,451 payments with 6,319 errors. That performance yielded an improved overall error rate of 4.3% for the year (at the time of this report, lockbox error data was available only up through October 2005). September and October of 2005 were the best months to date, posting error rates of 3.2% and 2.7%, respectively.

According to Wachovia representatives, when bill payment information is keyed or scanned incorrectly, the bill is rejected. Then the rejected bills and payments are sent to the Finance Department for further processing. Finance staff reviews the rejected bills and determines which customer account should be credited with payment; the bill is then processed internally by Treasury staff and the payments are re-deposited with Wachovia. The bank receives and processes the deposit and credits it to the City's account.

Processing errors cause extra work for Finance Department employees. This extra work makes the bill payment process less efficient and more costly. Wachovia representatives attribute the errors to mutilated or otherwise unreadable bill coupons or checks, which the bank often can't control. Mistakes made by keyboard operators when entering payment information also was identified as another source of errors, but no data

was available from Wachovia regarding the type and frequency of those or other specific errors.

> **Recommendation 41: Establish quarterly meetings with Wachovia representatives to review data on specific error types and to agree on a course of action for minimizing those errors.** It appears that error rates have declined as Wachovia data-entry clerks have gained more experience with the types of payments processed for the City.

One way to motivate service providers is to offer performance incentives tied to verifiable benchmarks. In this case, the performance benchmark is the error rate of Wachovia's data processing clerks. By paying financial bonuses for low error rates – coupled, perhaps, with financial penalties for high error rates – the City would motivate Wachovia to seek better performance. At this time, however, the City's agreement with Wachovia does not include performance incentives.

> **Recommendation 42: Consider using performance incentives as a way to motivate Wachovia to reduce data entry errors.** The current contract should be amended or any new contract should include a performance incentive provision. For example, if Wachovia's monthly error rate is 2.0% or less, the City would increase the amount paid per piece to 27¢; if the monthly error rate exceeds 5.5%, however, then the City would decrease the amount paid per piece to 23¢.

CROSS-TRAIN ADDITIONAL PAYROLL STAFF

Currently, only one Accounting & Fiscal Management staff member is assigned to process the payroll for more than 700 City employees. The Division Manager reports this situation has led to high levels of staff stress, particularly if the Payroll Clerk is on vacation or has taken sick leave. Since the payroll function is so critical, it is essential for the Finance Department to ensure adequate backup personnel are trained and available to assist with processing payroll if needed.

> **Recommendation 43: Designate and train at least two other staff members from the Accounting or Treasury divisions to assist with payroll processing.** The union contract may limit the amount of cross-training permitted. If so, changes in the contract should be negotiated to enable cross-training to occur. Cross training benefits the City and the employee, and it should be welcomed by the union.

> **Recommendation 44: Discuss consolidating payroll functions with Berks County.** Both local governments process payroll, and economies of scale would result from combining those functions.

TREASURY

The Treasury Division processes all cash receipts and bank transfers for the City. The division receives in-person cash or check payments made at City Hall for tax payments, water bills, annual recycling payments, and solid waste collection fees. Typical daily activities include:

- Accepting and processing payments from residential and business property owners.
- Processing checks, fees and payments from other City departments.
- Researching payment and account histories.
- Processing office mail.

Other Treasury duties include issuing event permits and collecting fees paid by citizens or others to obtain copies of police reports. Treasury employees also maintain a database of customer accounts that have non-sufficient funds and associated late fees. Finally, the Treasury Division processes tax certifications for title companies.

The 2006 budget includes funding for one chief treasury clerk and three clerk typist II positions. All clerks share and rotate office duties via weekly assignment. While the Chief Clerk supervises day-to-day operations in the Treasury Division, the Accounting & Treasury Manager is responsible for general oversight of the division. (As discussed in the previous section, the Accounting & Treasury Manager also has responsibility for managing the Accounting & Fiscal Management Division of the Finance Department.)

Most of the current Treasury staff has worked in the division for several years. The Accounting & Treasury Manager reports only one new employee has been hired in the past two-and-a-half years.

Analysis & Recommendations

The treasury function involves fairly routine work processes. Treasury Division staff appear to have a methodical approach to processing payments and resolving errors in a systematic and predictable manner. According to the Accounting & Treasury Manager, treasury processes have been done the same way for years, without any formal review of how processes could or should be improved. However, whether those

legacy procedures are the most efficient way of processing payments is uncertain.

BEST PRACTICES – TREASURY OPERATIONS
As discussed in the Accounting & Fiscal Management section, the Finance Department has already implemented one GFOA best practice, which is to use a lockbox service for processing and collecting utility bill payments. Some other best practices discussed by researchers from the GFOA Research Center in "Best Practices in Treasury Management," (*Government Finance Review*, April 2000) include using computerized cashiering systems – or "point-of-sale" systems – when customers pay fines or fees at City Hall; accepting credit card payments for fines and fees; allowing customers to use electronic funds transfers to pay City bills; and using "positive pay" check matching programs to deter check fraud that targets the City's bank account. Implementing some or all these practices would benefit the Treasury by getting cash in quickly and holding onto it for as long as possible before disbursal.

Point-of-Sale System
Local governments now can collect and process funds the same way merchants and others in the private sector do: flexibility in the type of payments accepted and automatic updates to a general ledger via a programmed interface link. This type of system eliminates manual journal entries. The result is better accuracy in account reconciliation.

> **Recommendation 45: Investigate the cost to install a point-of-sale system in the Treasury Division and other City operations that accept payments directly from customers.**

Credit Card Payments
More and more local governments are beginning to accept credit cards for customer payments of bills, fines and fees. One reason acceptance has been slow is that credit card companies charge an "interchange" fee to those who accept credit card payments. Local governments have understandably been reluctant to pay those fees. (One option might be for local governments to pass along those costs to customers who choose to use a credit card – almost like a processing fee.)

However, an offset to the interchange fee is that credit card payment systems can be set up to verify card authenticity and funds availability for each customer who uses a credit card. Verifying cards and funds eliminates the staff time and expense required for following up on a returned check, for example, which ultimately saves the jurisdiction money. While not the answer for all bill payment situations, some customers may find the credit card option desirable.

> **Recommendation 46: Examine the feasibility and desirability of offering customers the option to pay City bills, fines or fees by credit card.**

Electronic Funds Transfer

Perhaps the most familiar example of electronic funds transfer (EFT) is the direct deposit of paychecks by an employer into an employee's account. EFT involves no paper processing, which is similar to credit card transactions. EFT differs from credit cards, however, by drawing funds directly from a customer's bank account, usually at pre-specified times. Withdrawals happen automatically after customers authorize the EFT to be set up.

This significantly reduces the staff time necessary to process bill payments. And by reducing staff costs, EFT significantly lowers the overall processing cost of each item. In one reported case those EFT costs were less than 7¢ per piece processed.

> **Recommendation 47: Consider offering the EFT option for customers to pay their City bills.** Offering this option would enable the City to reduce the cost of processing utility bills and other payments. Although the City currently uses Wachovia to perform lockbox services, Wachovia's average fee per piece processed is 25.5¢ (not including fixed monthly costs). If the EFT cost per piece processed is lower than Wachovia's fee, the City would save money by processing more transactions via EFT.

Positive Pay Verification

State-of-the-art check fraud has flourished with the advent of high-quality printers and copiers, and local law enforcement professionals recommend the use of proactive defensive strategies to protect against such fraud. Most banks offer a service where any paper check issued by a local government is matched against a list of authorized payees. This is a strong defense against fraudulent checks.

> **Recommendation 48: Contact the City's primary bank to discuss the availability and cost of positive pay verification.**

CUSTOMER SERVICE TRAINING

The Treasury counter may be the first or only time citizens or business owners deal with City employees face-to-face. Even by implementing a variety of customer-friendly payment options, Treasury staff will still deal with citizens and business owners who must pay taxes, fees, or fines.

These are generally not thought of as pleasant activities. Staff reported that customers at the counter sometimes became belligerent or abusive, making the work atmosphere tense. However, according to the Accounting & Treasury Manager, no formal customer service training has been provided to front-line Treasury staff. It is important for front-counter staff to learn techniques that can help defuse potentially confrontational situations while still providing good customer service.

Recommendation 49: Provide customer service training to Treasury staff to help them cope with unhappy or hostile customers and situations in ways that reflect positively upon the City.

REVIEW MANAGEMENT STRUCTURE

As discussed previously in the Accounting & Fiscal Management section, the Accounting & Treasury Manager oversees both accounting and treasury functions. The Accounting & Treasury Manager spends the vast majority of her time on accounting functions. A Chief Treasury Clerk currently supervises the daily operation of the treasury function. In addition, the Treasury Division uses Hansen software; the Accounting Division uses USL, which is a different software package altogether.

Recommendation 50: Give the current division supervisor direct management oversight of treasury operations. The Chief Clerk already supervises the daily functions of the Treasury, and it is a best practice to directly link management authority and responsibility with accountability. (A similar recommendation is made in the preceding Accounting & Fiscal Management section of this report.)

HANSEN SOFTWARE ISSUES

In her observation of day-to-day operations, the Chief Treasury Clerk reports that using Hansen is time consuming, particularly for processing tax payments. Time delays are problematic because the Hansen software is an integral part of how Treasury staff codes, enters and tracks payments received from customers. Some functions require Treasury employees to use cumbersome "workarounds" to receive and post payments. (For example: the Chief Clerk reports that the system will not allow a payment entry if a prior-year balance exists; she also reports that Hansen lists incorrect transaction numbers for various entries.)

Establish User Group

All in all, the Chief Treasury Clerk estimates that since Hansen was implemented, the number of daily transactions each employee processes per day has been reduced by 28%. Therefore, the Hansen software issue is raised here again to reinforce the recommendations about Hansen that were initially made in the *Administration* section of this report.

Recommendation 51: Establish a user group to identify issues with Hansen software.

Staff Training

In conjunction with the recommendation above, Treasury staff should receive additional training in using Hansen software. The training should address both daily and non-routine processes that are difficult or time consuming to execute. Finally, training should also identify and address shortcuts that can help speed the completion of transactions.

Recommendation 52: Require Treasury staff to take training on the use of the City's Hansen software.

PURCHASING

The Purchasing Division helps other City departments procure goods and services. The division works with other departments to develop bid specifications; advertise and seek bids; review and award bids; and maintain written records of bids, bid awards, and women and minority contractors. Division staff are responsible for monitoring City compliance with all applicable federal, state, and local rules and regulations related to purchasing. The Purchasing Division also manages in-house printing operations.

The 2006 budget authorizes one purchasing coordinator. This is a reduction from previous years when the Purchasing Division also included one secretary and one purchasing agent.

The division used to be managed by the recently appointed Finance Director. Now, with the budgeted reduction in staff, and the appointment of the Acting Finance Director (formerly the Purchasing Director) as permanent Finance Director, the purchasing function will rely solely on one employee.

Analysis & Recommendation

The purchasing procedures used in the Purchasing Division appear sound. The Finance Director indicates that the current Purchasing Coordinator has worked in the Purchasing Division for several years, and knows the process well.

The Purchasing Coordinator handles all verbal or written price quotes for purchases over $500 and under $10,000. Purchases over $10,000 (and which are not for professional services) are advertised and require formal bids responses to be submitted. Vendors must submit sealed bid responses and also must post a bid surety to be considered for bid award. Written records are maintained for each bid.

Any purchase of professional services for more than $10,000 must be initiated by a Request for Proposal. Bid awards for professional services are made by written contract, unless the Managing Director authorizes otherwise.

PURCHASING PROCESS IMPROVEMENTS

The Finance Director identified two key initiatives for the Purchasing Division to pursue in 2006: 1) begin using online bidding; and 2) begin using performance-based contracting. With reduced staff levels, initiating both initiatives successfully will take careful planning and monitoring.

> **Recommendation 53: Implement online bidding and performance-based contracting.** Online bidding – sometimes known as "reverse auctions" – requires computer network capability to host auctions, receive and monitor bids, and award bids. Staff training also may be necessary to ensure comfort with the online bidding process.

PENSION ADMINISTRATION

The Pension Board governs pension fund administration and investments for the City's police, fire, and non-uniformed employees. The City pays pension benefits to approximately 580 former Reading employees: 300 "non-uniform" retirees (generally defined as any retired employee who was not a police officer or firefighter), 200 retired police officers, and 80 retired firefighters. The Pension Board coordinates payments to retired employees through Pension Administration.

Pension Administration also assists employees in determining eligibility for retirement or the Deferred Retirement Option Plan (DROP). Twelve police officers are now enrolled in the DROP program. This program also offered to Fire employees as of January 2006.

Historically, one full-time staff person administered pensions for the City. Until November 2005, the Pension Administrator reported to the Human Resources Director and worked closely with the Finance Director. The Pension Administrator position now has been transferred to the Finance Department, but the position was vacant at the time this report was written.

Analysis & Recommendations

Monthly pension disbursements are made using multiple methods. An estimated two-thirds of total disbursements are made through direct deposit, while the remaining one-third are disbursed via checks that are either mailed out or picked up in person from the Human Resources office.

Police and fire pension disbursements are issued once a month; payments to non-uniformed retirees are issued twice a month. From a process perspective, having two different disbursement methods is inefficient. A much more efficient solution would be to disburse all pension disbursements via direct deposit.

DISBURSE PENSION PAYMENTS UNIFORMLY
A uniform system of once-a-month disbursements using electronic funds transfer (otherwise known as "direct deposit") will eliminate the need to write separate pension checks for one-third of the City's retirees. Implementing that protocol creates efficiencies by reducing the staff time required for processing a second monthly mailing and for making over-the-counter disbursements.

Recommendation 54: Implement a uniform method for making monthly pension disbursements.

REVIEW PENSION ADMINISTRATION MODELS

The Pension Board is currently researching the costs and benefits of hiring a Pension Administrator for the Finance Department versus outsourcing the pension function altogether. No comparison can be completed until more information is obtained about each proposal's short-term and long-term costs.

Recommendation 55: Assess the costs and benefits of hiring an in-house Pension Administrator for the Finance Department versus the costs and benefits of outsourcing the pension function.

CONCLUSION

The review of the Finance Department generated 55 recommendations for the City's management team to consider implementing. These recommendations will help management and staff make substantial and long-term improvements in the City's operations.

One recommendation in particular may be viewed with trepidation by employees in the Tax Administration Division. The last recommendation in that section urges the City to discuss consolidating the tax collection and processing functions with the Berks EIT Bureau. That recommendation is not a negative reflection on the employees working in the division. Rather, the recommendation was formulated in light of Pennsylvania's pending move toward consolidated tax collection services. The recommendation also recognizes that the Berks EIT Bureau has refined the tax processing for BPT, EIT and EMST to the point where the service can be provided more efficiently to City taxpayers. The Berks EIT Bureau has indicated that using its services would certainly be more cost effective for the Reading School District.

It should be noted that if some consolidation with Berks EIT Bureau occurs, the Tax Administration Division will continue to exist. The City still must collect and process the City's real property tax and the Per Capita tax, because the Berks EIT Bureau does not handle those particular taxes.

Finally, all the City employees we met were interested in helping move the City forward. Employees appeared to be genuinely willing to work together in finding solutions to the City's problems. The City's executive and management team also is commended for its openness and assistance throughout this process.